Housing Policy for the 1980s

G. B. Fallis

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PREFACE

We are at a time of decision in the development of housing policy in Ontario. The post-war period has seen a continual expansion of government activity in the housing sphere. It began with housing assistance for the returning veterans and expanded to include mortgage insurance, then public housing for low income households, and finally assistance for moderate-income families for the purchase of a home. In the late 1970s this expansion stopped and housing programs of all types were curtailed. This was caused by several factors: the sense of a housing 'crisis' had passed; the desire to restrain government expenditure was accommodated partially by curtailing housing programs; but perhaps most important of all, there was dissatisfaction with the existing approaches to solving our housing problems. We now have the opportunity to examine and learn from the experience of the last thirty years and to implement new responses.

The purpose of this paper is to stimulate public discussion about the future direction of housing policy. It takes a broad view of policy. The paper considers not just explicit housing programs but other major public sector influences on housing as well. It argues that many housing programs are actually attempts to redistribute income and hence income supplements must be considered as alternatives to housing programs.

The paper is divided into three parts. The first section describes current housing policy by reviewing the long expansion of housing activity and the recent period of restraint. The expenditures, taxes, and regulations of government are described. The second section outlines a framework for the economic analysis of housing programs. Economic analysis has been little applied in the past but is required for the second development of future policy. On the basis of this framework and the lessons of the past years, the third section makes specific recommendations for policy in the future.

Government policy can never be found in a single document outlining goals, objectives, and methods of implementation. Rather, policy must be discerned in all the actions of government - statements of elected representatives, legislation, administrative decisions, expenditures, tax collections, and regulatory activities. Often, some action of government apparently quite unrelated to the issues at hand will have an important influence; for example, an increase in the old age pension may do more to increase the housing consumed by the elderly than any explicit housing assistance program. It is this totality of government influence on the housing sphere which must be considered in an examination of housing policy. In what follows, the various levels of government - federal, provincial, regional, and local - will be considered as one. In housing matters, sometimes jurisdiction is exclusively at one level, sometimes it is shared; sometimes a government designs a program to stand on its own, sometimes to piggy-back on a program of another government; sometimes costs are borne exclusively, sometimes they are shared. No easy separation into component parts is possible.[1]

This section outlines housing policy in Ontario by examining its evolution from the Second World War to the present.[2] The purpose is to outline the main themes and approaches rather than to detail the specifics of individual programs. An historical approach is doubly important because it shows our past strategies, and also it describes what exists today. Many old programs are part of current policy, although no longer making new loans or grants, because they continue to offer assistance to households which entered the programs in previous years.

The most significant characteristic of post-war housing policy is the continual expansion of activity from the early 1950s until the later 1970s, followed by several years of restraint and even contraction. No com-

1 The problem of specifying the optimal or best structure of government for the execution of housing policy will not be dealt with in this discussion paper. Since no criteria are developed, no criticism will be made of existing government arrangements.

2 Numerous more detailed histories of Canadian and Ontario housing policies are available (City of Toronto, 1976; CMHC, 1979; Dennis and Fish, 1972; Fallis, 1980; Ontario Economic Council, 1976; Smith, 1974, 1977; and Rose, 1969). These provide details of various programs and qualitative analysis of their effects.

prehensive measure of government policy is possible, but a look at the behaviour of expenditures, the changes in the tax laws, and the changes in regulatory activity all reveal a roughly similar pattern.

Expenditure

The most obvious initiatives dealing with housing issues are those programs which result in expenditures explicitly directed to housing. Good proxies for the size of these programs of all levels of government are the loans and expenditures by Canada Mortgage and Housing Corporation (CMHC) shown in Figure 1. The real value of loans reflects new activity in any one year. The data show the long-term growth trend, with marked variation between years, and followed by sharp contraction. The data on real expenditures measure the annual subsidies associated with all programs present and past. For example, each year subsidies are paid on public housing projects built many years ago. These data show uninterrupted growth. Thus the present situation has two differing aspects - no new programs have been started and few new loans are being made under old programs; but annual expenditures continue to rise because of previous commitments.

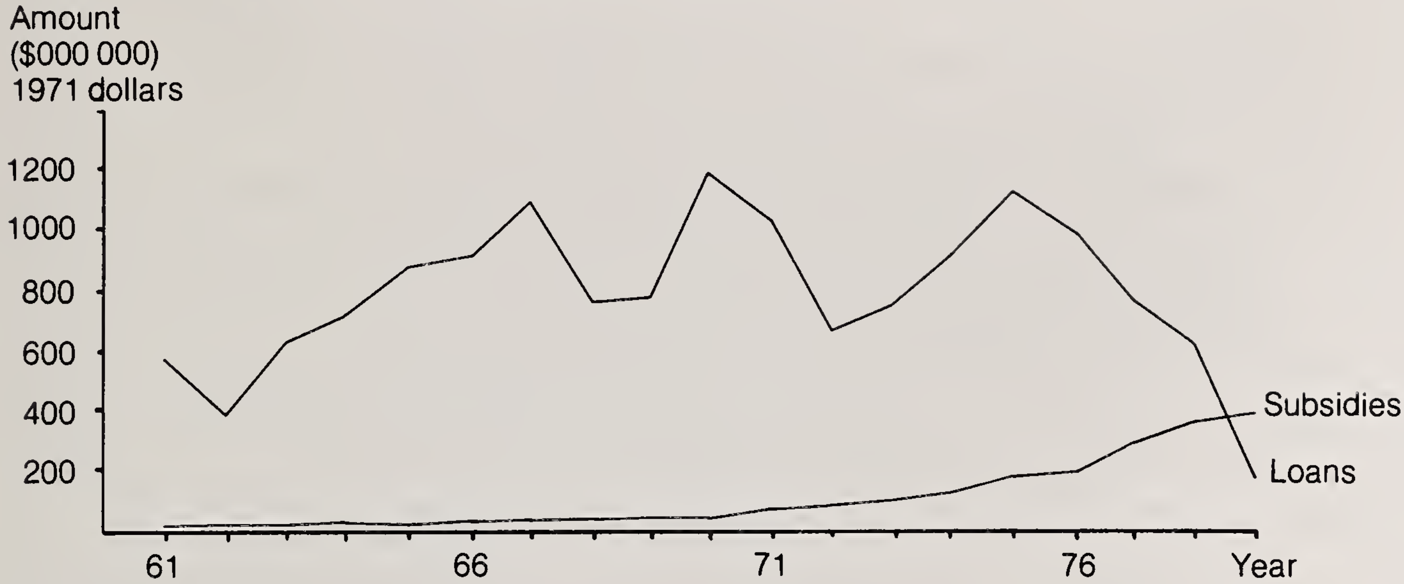
This long expansion was caused by the widening concerns of governments. Until about 1964, housing policy was designed to ensure the smooth functioning of private housing and mortgage markets. The main programs were mortgage insurance and direct lending by CMHC, both of which still exist although little direct lending is done. After 1964, concern extended to the difficulties of renting housing faced by low- and middle-income households. Finally, in the late 1960s and early 1970s concern included the problems of buying a house faced by middle-income families.

The major program for low-income renters was public housing, under which government-owned accommodation was rented to families and the elderly in accordance with what they could afford rather than the market rent. In 1971, CMHC lent almost $300 million for such building in all of Canada. From 1969 to 1971, public housing represented almost 14 per cent

3 These were the years of greatest activity under the public housing program. Currently, about 2 per cent of total housing stock in Canada is public housing.

Figure 1

Real loans and subsidies, 1961-79:
Canada Mortgage and Housing Corporation



Source: CMHC (various years). Loans and subsidies data are on a commitments basis rather than an outlay basis. The nominal data were deflated using the composite index of residential construction costs.

of all housing starts in Ontario.[3] The program came under increasing attack because it stigmatized and ghettoized the poor, and because projects were often located far from the social services used by the occupants and from their jobs. A rent supplement approach in which the government arranges with private landlords for the accommodation of subsidized tenants was begun as an alternative, but the new program has remained small. Some new public housing is being built, although almost exclusively for senior citizens.

A group of other programs also grew, all designed to construct housing which would rent to moderate income families at slightly less than market rates. The mechanics and details differed among the several programs (Non-Profit Housing, Co-operative Housing, Assisted Rental Program), but in essence each provided public mortgage loans at interest rates below the market level. The amount of new loans has declined appreciably in recent years.

The scope of government activity increased further as programs to assist homeowners were begun. Previously these households, which of course had to be moderately well off to consider buying a house, had received little direct assistance. Ontario's Home Ownership Made Easy Plan and the federal Assisted Home Ownership Program (AHOP) provided assist-

ance to reduce the annual carrying costs of a home. Often, the level of subsidy was higher than for public housing tenants (Fallis, 1980, 135). Both programs were large, but AHOP was enormous. In 1974 and 1975, CMHC made almost $1 billion in mortgage loans under the program. However, restraint hit hardest here, and now there is almost no new assistance available for ownership.[4]

These subsidy programs for owners and renters, although differing greatly in form, all had essentially the same effect on a participant: a certain quantity of housing was offered at less than the market price. There was relatively little choice about the location and amount of housing. Those who participated in the program were made better off and usually consumed more housing and more of other goods than without the program.

There was also signficant growth in the loans and grants made by CMHC to municipalities to help finance sewage treatment facilities. These intergovernmental transfers indicate increased public expenditure to service land and upgrade sewage treatment systems. There appears to be little expenditure restraint in this area.

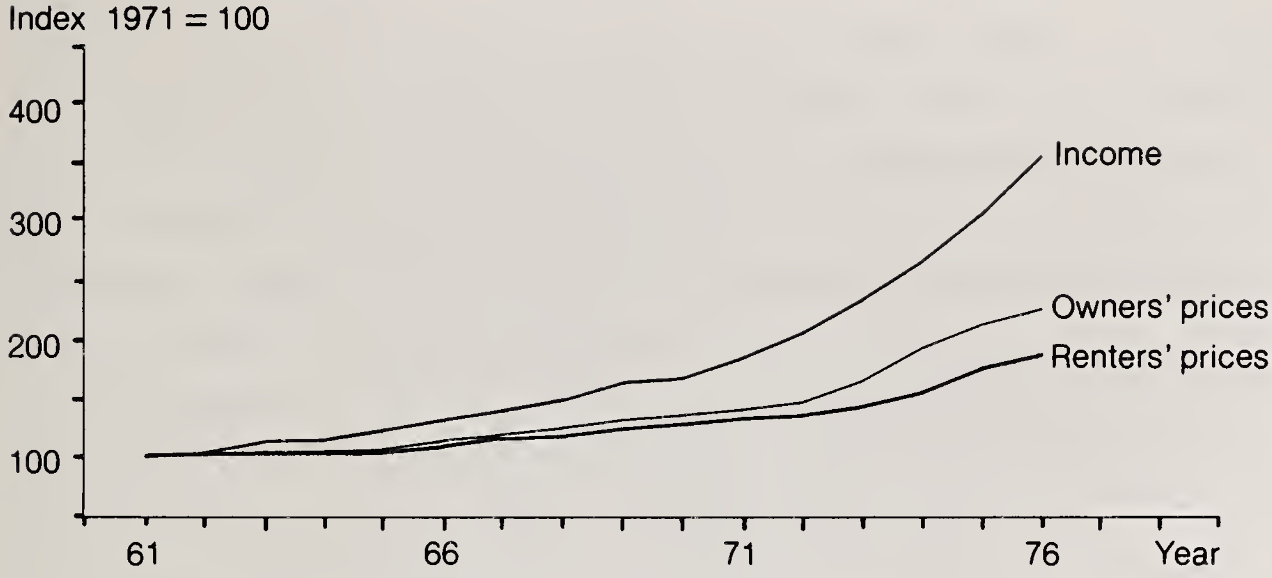
The expansion of assistance programs was fuelled by a public perception that increases in house prices and rents were greatly outstripping increases in incomes. It was argued that people needed assistance, sometimes desperately. While public perceptions are real enough for politicians, it is important to examine as well the actual data before developing new policies.

At the outset, it should be recognized that a comparison between rents or annual housing carrying costs and incomes cannot answer the fundamental question of whether people are getting worse off as a result of price changes. Prices of some commodities will rise rapidly, while prices of others will rise less rapidly. The fundamental issue is whether incomes have risen fast enough to compensate for the price changes in <u>all</u> the commodities which consumers normally buy. This comparison, graphed in Figure 2, reveals that households, whether owners or renters, have become considerably better off since 1961.[5] Incomes have risen by far more

4 CMHC still makes loans; however, they are merely a form of graduated payment mortgage, an instrument which is also available from private financial institutions.

5 These data, of course, deal only with averages. Households on fixed incomes or whose incomes have grown far below the average rate may

Figure 2
Prices and income, 1961-76



Source: Fallis (1980, 28-32).

than the cost of buying the normal bundle of goods, including housing.

These data conflict directly with the public perception that it has become increasingly difficult for young families to buy a house. As is often the case there is truth in both positions. What has been happening is that house prices and mortgage interest rates have been rising extremely rapidly. Annual carrying costs have risen faster than incomes (although considering the average of all prices people are still better off). Furthermore, mortgages usually keep nominal payments constant over the term of the mortgage, which in times of inflation implies that real payments are highest when the home is purchased. However, when approving mortgage loans, financial institutions have a rule which sets the maximum allowable carrying charge at approximately one-third of income. This rule has not changed over the period. As a result, the average family is less and less able to finance the purchase of a house.

Taxation

Probably the most significant influence of the public sector on the housing sphere results from the tax system. Numerous special provisions of the income tax system, special taxes relating to housing, and the residential

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have become worse off. In recent years, many workers have suffered losses in real incomes despite real growth of the entire economy.

property tax all combine to create the impact. This tends to be forgotten by those who focus on the expenditure programs. The increasing government involvement in housing can be seen in the taxation area as well.

The major taxes influencing housing have remained unchanged in the post-war period. The income tax system has always excluded from taxable income the imputed income from a home owned by a taxpayer.[6] Thus taxpayers who finance the purchase of housing using their own savings pay lower taxes than similar taxpayers who place their savings in stocks or bonds and rent housing. The forgone federal tax revenue due to this provision has been estimated to be $3.7 billion in 1979 (Canada, 1979), causing a large transfer from all taxpayers to owners. The income tax system has also always permitted taxpayers with rental income to make depreciation deductions in excess of real economic depreciation. All renters benefit at the expense of other taxpayers, assuming the provision is passed forward in reduced rents. The other major tax influence, the residential property tax, has also existed throughout the period. This tax can be thought of as a tax on housing wealth or alternatively as a sales tax on the annual flow of housing services. The effective rate of taxation, defined as the ratio of residential property to market value, is not the same across all types of property. Rates are lower on older single detached houses than newer, and lower on owner-occupied houses than on rented (Bird and Slack, 1978, 14).

In the late 1960s and early 1970s, extensive use was made of the tax system to influence the housing sector. In 1972, Ontario instituted a property tax credit scheme. Taxpayers are allowed a refundable tax credit based on their property tax payments or rental payments. The credit declines as income increases, and disappears for moderate and high income taxpayers. These provisions have the effect of a reduction in the price of housing.

At the end of 1971, the tax reforms stimulated by the report of the Carter Commission (Canada, 1966) were implemented. As part of the package, 50 per cent of realized capital gains were defined as taxable income. However, the capital gains realized on the sale of a taxpayer's principal residence were granted an exemption, despite the recommenda-

6 The exemption of imputed income has received extensive economic analysis. Examples of the recent literature include Aaron (1970), Laidler (1969), White and White (1977), and Rosen (1979).

tions of the Carter Commission. The Department of Finance (Canada, 1979) estimates forgone federal taxes to be $2.5 billion. In 1974, the Registered Home Ownership Savings Plan was instituted, permitting taxpayers to deduct contributions made to a savings fund which will be used to purchase a home. Contributions of up to $1 000 per year to a maximum of $10 000 may be deducted from taxable income. In 1979, it is estimated that deductions resulted in federal taxes forgone of over $105 million (Canada, 1979). Both provisions shift resources from all taxpayers to those saving to become homeowners.

Numerous changes in the income tax regulations relating to investment in residential real estate have been made over the last fifteen years. Rules for recapture of excess depreciation have been tightened, the right to apply real estate capital cost allowances against other income has been curtailed, and tax shelter advantages for investment in certain multiple unit residential buildings (MURBs) were instituted and are now being phased out. Smith (1977) argues that these have signficantly reduced the attractiveness of residential real estate investments and so raised equilibrium rents. However, most of these should be seen as a reduction in public sector influence because a more neutral treatment of real estate as compared to other investments is being established.[7]

On balance, the tax changes have benefited existing and potential homeowners at the expense of other taxpayers. The federal Progressive Conservative party recommends a continuation of this evolution, proposing a property tax and mortgage interest tax credit. Critics of the proposal have suggested a shelter tax credit system for both owners and renters as an alternative. The continued expansion of housing programs using the tax system seems quite likely.

Regulation

The last major influence of public policy on housing results from the laws, by-laws, and regulations governing private behaviour. Although there are no cash outlays or forgone revenues, these regulations have a powerful impact. Again, there has always been regulation of the housing sector but

7 For further discussion of the income tax treatment of residential real estate, see Canadian Tax Foundation (1973, 1977).

it increased until the late 1970s, when a period of restraint seems to have begun. Controls have always been exercised in several areas: there has been control of building standards through building codes, and control of land use at a regional level through provincial laws, and at a local level through municipal by-laws which govern new plans of subdivision and redevelopment.

It is land use regulations which have become more constraining. At the provincial level, an elaborate exercise was begun in the mid-1960s to plan land use patterns so that the growth of Toronto would be limited and the growth of medium-size cities encouraged. Numerous reports were published and maps produced designating land uses, including a parkway belt surrounding Toronto. The present government seems to have abandoned plans to implement provincial land use controls for the Toronto region, although signficiant controls were placed on rural land severances and land use on the Niagara Escarpment (Frankena and Scheffman, 1980). At the local level, land use controls have become increasingly strict, reflecting public concern for environmental quality. A Ministry of Housing report (Ontario, 1976) indicated that relaxation of some local controls would permit lower-priced single houses to be sold.[8] There has been some limited experimentation with relaxed development standards, and the trend to more restrictive controls appears to have ceased for the time being.

The last five years have seen massive expansion of regulatory activity: rent controls. The controls, called rent review, were begun as part of the federal Anti-Inflation Program, but have outlived the larger control program. Under Rent Review, a landlord is permitted one rent increase per twelve-month period on each unit and may pass on only certain increases in operating costs and certain capital expenditures (see Arnott, forthcoming, for details). New buildings and major renovations are exempt. The intention seems to be to slow the rate of rent increases without influencing the long-run equilibrium rent. There does not appear to be any plan to remove rent controls.

A comprehensive examination of housing policy would include many other activities of the public sector. Transportation programs, immigration

8 This does not imply that the price for a standard unit of housing has fallen necessarily, merely that smaller houses, on smaller lots, in subdivisions with narrower streets are available where previously they were forbidden.

regulations, and income security payments, for example, all influence the housing sector, although often inadvertently. Of great importance is the influence of specific expenditures on specific houses. A new school or park or subway will increase the value of adjacent houses and apartments. This brief review has sketched only the major aspects of past developments and current policy.

THE ECONOMIC ANALYSIS OF HOUSING POLICY

The previous section reviewed housing policy in purely descriptive terms. In order to evaluate these programs, criteria for judgement must be established. These criteria set out what is the desirable state of the world. Then one can judge what sorts of changes are desirable and make a choice among alternative programs. In the past, the criteria of economic analysis - that resources should be efficiently allocated and that output should be fairly distributed - have not been applied in the development and design of housing programs. For example, most housing policy has reflected the implicit assumption that 'we need more houses.' Of course more houses would be desirable if society could keep the same amount of everything else. But more housing always implies less of other things. What if more houses means fewer hospitals for the elderly, or reduced private expenditure on consumer goods, or a decline in investment in new energy sources? Then it becomes less evident that 'we need more houses.' The criterion of efficient resource allocation forces examination of these trade-offs and provides a framework for making choices. Also it has been assumed that 'housing assistance is needed' without articulating the standards of fairness which should govern the distribution of help.

A necessary part of developing a housing policy for the 1980s is to undertake an economic analysis of the housing sector. This section lays out the framework.[9] The first step is to examine the situation without any government housing programs and ask: would resources be efficiently allocated, and would the distribution of income be fair? If the answer is negative, a problem exists and there is a possible role for government.

9 A good introductory discussion of this framework and its application to the study of provincial land use policy is presented in Frankena and Scheffman (1980). References of a more technical nature are Mishan (1976), Layard (1972), and Prest and Turvey (1965).

Next, the results of a program must be predicted and the world with and without government compared. Finally, if the program results in an improvement according to the criteria of efficiency and equity, it ought to be implemented.

Efficiency issues

A common cause of inefficient resource allocation in a world without government is non-competitive markets.[10] Both the markets for inputs into housing - labour, mortgage, land, and building materials markets - and the housing markets for new and existing housing must be scrutinized. If it can be shown that market power exists, then there is potential for the misallocation of resources. This, of course, is no easy task. In order to establish the existence of market power, it must be shown that a small number of firms dominates the industry and that there are barriers to new firms entering the industry.[11] If market power exists, several responses are possible - most importantly, the regulation of the industry, the break-up of the dominant units in the market, or the removal of barriers to entry.

Sometimes it is alleged that speculation in the land market can raise prices and therefore distort resource allocation. Markusen and Scheffman (1978) discuss conditions under which speculation raises prices and show that the general case of speculation always raising prices cannot be demonstrated. Solutions to inefficiency caused by speculation would be regulation, special tax measures (for example the Land Speculation Tax in Ontario), or increased down payment requirements for land purchases.

A second important cause of inefficiency is externalities. If society derives benefits from people's consumption of housing, society should consider subsidizing the price of housing to reflect these benefits. Without such subsidies people will not consume enough housing because they

10 The problem of public goods is ignored because housing is so evidently a private good.

11 Muller (1978) examined concnetration in the development industry, and Markusen and Scheffman (1977) looked at land ownership in the Metropolitan Toronto area and both found little evidence to suggest significant market power. The Land Task Force (1978) in a study of several cities in Canada reached similar conclusions. The industry collecting, treating, and distributing water and sewage is a natural monopoly, which has been dealt with by public provision.

do not take the social benefits into account when deciding how to spend their money. Many of our housing programs take the form of reducing the price of housing to a household, and it would be tempting to argue that the programs have been designed to take care of externalities. However, it is extremely difficult to identify these externalities precisely and even more difficult to measure them and therefore to know the appropriate rate of subsidy. DeSalvo (1971) outlines a framework which indicates the size of such externalities needed to justify a price reduction subsidy. Fallis (1980, 40) examined a number of housing programs in Ontario and found the level of subsidy was often 'far larger than any realistic estimate of the externalities.' Furthermore, the existence of externalities would call for universal programs rather than our current programs, which assist only a small fraction of the eligible groups.[12]

A similar argument can be made for subsidizing home ownership on the basis of external social benefits resulting from the form of tenure, but again the externalities are difficult to identify and to measure. This does not imply that the externalities are non-existent. It is clearly a deeply and widely held view among Canadians that a society of homeowners is desirable.

Inefficiency can also arise if the private market rate of interest is an inappropriate guide for making all investment decisions. If the interaction of borrowers and lenders in the financial markets yields a lower value on the future than society collectively (ie, the interest rate is too high), there can be a role for government to undertake or subsidize investment projects. This argument is seldom made in support of more investment in housing; indeed, it is usually made by those who wish to restrict investment in housing and preserve agricultural land. Private interest rates may also be too high because the risk premium in the interest rate is high compared to a public sector risk premium which may be lower due to risk-pooling (see Boadway, 1979, for a discussion of these issues).

It is often argued that resources are inefficiently allocated because of imperfectly functioning capital markets, although the precise cause of these

12 It might be assumed that these externalities only exist when a household consumes less than the socially acceptable quantity of housing; in which case, price subsidies would only be extended to those who consume little housing. This concept of externalities is similar to the concept of donor preference arising in discussions of redistribution.

market imperfections is often unspecified. Insufficient funds, it is alleged, are allocated to the mortgage market. Therefore public initiative is required to increase the flow of funds; for example, by establishing mortgage insurance or secondary mortgage markets. Recently, a possible imperfection has received much attention. In times of inflation, constant nominal payments over the term of a mortgage imply declining real payments. A new mortgage instrument which would maintain constant real payments over the term of the mortgage would increase the flow of mortgage funds. Such an instrument has not been provided by the private sector and thus, it is argued, should be offered by the public sector.

These several cases of inefficient resource allocation have considered only the situation where individuals and firms interacted in a world without government. It is also possible that inefficiency can result from governments interacting. Local governments competing among themselves, each representing the interests of their constituents, can lead to a situation which is inefficient from a wider social point of view. For example, local governments may prohibit growth, or restrictively zone land so that only large houses may be built, or restrictively zone existing neighbourhoods so that conversion to multiple unit dwellings cannot occur. In society's eyes, this may result in cities which are too small, or in too few small homes or rental units. There is a case for higher levels of government to forbid such restrictive zoning or to offer subsidies to local governments so their decisions will yield efficient allocation of resources[13] (see Mills and Oates, 1975).

Equity issues

The second fundamental question which must be asked is 'would the distribution of income be unfair without government intervention?' If the situation is unfair, a program might be mounted to redistribute resources to deserving households. The question is especially difficult to answer for policy analysts, because teir training, however excellent, gives no guid-

13 This is an example of the more general problem of intergovernmental financial arrangements in a federal system. Usually any assignment of expenditure responsibilities and revenue-raising instruments will necessitate shared-cost programs or intergovernmental grants. This discussion paper does not analyse the optimal structure of government and intergovernmental transfers.

ance about what is fair. It is an issue of justice, rather than social science. Do we want everyone to have the same income? Do we want incomes to vary according to hours of work, skills of the workers, effort of the workers; or should everyone be entitled to whatever they earn in the marketplace? In our society, we rely on the political system to answer this question and to implement any redistribution.[14]

Although a precise articulation of our collective idea of equity cannot be found, it seems clear that we desire a more equal distribution of resources than would exist in the absence of government. Furthermore, redistribution should conform to the principles of horizontal equity - that similar households receive similar assistance - and vertical equity - that households in greater need receive greater assistance.

It is of fundamental importance in the design of housing programs to understand whether the purpose is to increase the consumption of housing or to raise the well-being of the participants.[15] A program designed to raise the well-being of the household would offer assistance in cash with no constraints on how the money is to be spent. An equal cost program designed to maximize the increase in housing consumption would offer a quantity of housing at a reduced price, such that the household would end up consuming more housing and less of other things.

Canadian housing programs seem to show aspects of both intentions. Households are constrained to consume more housing than they would have under a cash grant. However, the programs also result in the household consuming more housing and more of other goods. Furthermore, the criterion for participating in programs is not quantity of existing accommodation but the income of the household.[16]

14 Individuals and groups also answer the questions and redistribute income through private charity. This is a small part of total redistribution.

15 If the donors (taxpayers) of the money for the redistribution prefer that the recipients spend it on housing, the issue is one of interdependent utility functions and may be examined as an externality question. Care must be taken in assigning great importance to donor preferences because a consistent argument would require that society intervene to deal with interdependent utilities arising from envy as well as benevolence. The restriction of the subsidy to housing may also be intended to insure that the benefits flow to all members of a family.

16 Entry to public housing is based on a point system, which includes consideration of the quantity of existing accommodation, but much more weight is given other factors.

Probably too much emphasis is placed on increasing housing consumption. Few households are inadequately housed in Canada. In 1976, only 4.3 per cent of all households lived in crowded conditions (more than one person per room) and only 3 per cent did not have hot and cold water (CMHC, 1979). Canadian housing programs should be recognized as part of the larger income support system. Alternatives to existing assistance, therefore, include direct income supplements.

The effect of a housing program

Having evaluated the world without government according to the criteria of efficiency and equity and established problems and possible responses of government, the next step is to forecast the effects of the programs.[17] This requires a thorough knowledge of the functioning of housing markets, of how consumers make their choice among commodities, and how decisions about supplying new and existing housing are made. Judgement of the success of a program will use as a standard whether the programs have achieved a more efficient and equitable allocation of resources.

To address the equity issues, the most important part in this forecast will be to predict what will happen to incomes of individual households after the government program is implemented. Initially, of course, the incomes of recipients rise by the value of the subsidy, but this may be offset by increases in house prices and rents. The increase in income may not accrue to the nominal beneficiary of the program but to owners of existing housing, or suppliers of inputs to new housing, perhaps owners of undeveloped land or construction labourers. Quite unintended people may be the true beneficiaries. This is a strong possibility when housing programs, such as shelter allowances or home purchase grants, give a direct stimulus to demand.

In order to predict price changes, one must forecast how demand will change, which requires knowledge of the price and income elasticities of the demand function. There now exists a reasonable consensus about these, the income elasticity being in the range of 0.7 to 0.9, and the price

17 Only the expenditure side will be considered here, but a full analysis would include the efficiency and equity effects of taxes or loans used to finance the program (or the reduction in other expenditures which finances the program).

elasticity of -0.5 to -0.7 (Quigley 1979). One must also forecast how supply will change through knowing, for example, the interest elasticity of supply; or if the supply does not change one must know the price elasticity of the supply curve. Considerably less agreement exists about these elasticities. Recent work suggests the price elasticity of supply to be in the range of 0.3 to 0.7 (de Leeuw and Ekanem, 1971). These estimates suggest a 10 per cent increase in income would raise prices by 7 per cent and a 10 per cent price subsidy would raise prices 5 per cent. Thus, there would be significant capitalization of a universal program and the benefits would not all accrue to the recipient of the subsidy.

It should be remembered that a price increase is not entirely a bad thing, although much attention is often directed to the issue. Higher prices act as signals to draw resources into the housing sector. If prices remain high in the long run, it may be an indication that resources needed to expand the quantity of housing have valuable uses elsewhere. For example, the land might be used in agriculture, the labour in building new factories, or the materials to construct bridges.

Those who forecast the impact of a government program frequently estimate the resulting new addition to the housing stock. Recalling the discussion above, the purpose of government activity should not be to increase the stock of housing, but rather to secure an efficient and equitable allocation of resources. Although an increased stock of housing may result, strictly speaking it is not the relevant issue. The net increases to the housing stock may be a proxy variable of interest if government does not deal with inefficiencies directly but instead uses public lending to increase the flow of resources into housing. In this context, it is important to realize that the housing financed under a government program may be offset by reductions in private construction, causing a relatively small net increase. Smith (1979a) argues that these offsets are large and have been ignored in much policy analysis.

The final step in policy analysis is to compare the world without a housing program to the forecast world with a housing program and to decide whether the change is worthwhile. It may be that an attempt to redress an inefficiency causes an equally costly inefficiency or that costs of administering a program outweigh the efficiency gains. If, however, the change is an improvement it should be undertaken.

When one juxtaposes this framework against the previous review of

housing policy it is immediately evident that economic analysis has played little part in the design of programs. The presumption seems to have been that more housing is better, with no attempt to identify (or deal with) the factors which have caused an inappropriate supply of housing. Indeed, many government actions have tended to promote concentration of the housing industry or even directly constrain the supply of new housing. Further, the presumption seems to have been that helping someone obtain more housing is good without any clear standard of equity applied. There are signficant horizontal and vertical inequities in the distribution of benefits. Policy for the 1980s would be greatly improved with a systematic application of economic analysis.

Housing policy and macroeconomic policy

A complete examination of government influence on the housing sector must deal with the relationship between housing and macroeconomic policy. The construction of new housing can commence with little lead time and be curtailed quickly as well. Thus, if the government wishes to expand aggregate demand, a new housing program is an effective instrument. If the government wishes to contract aggregate demand, it can curtail housing programs or it can use restrictive monetary policy and resulting high interest rates, which will reduce output in the housing sector because housing investment is highly levered. Macroeconomic policies, therefore, often strongly alter the level of housing construction. Housing itself is subject to a cycle, apart from any influence of government, which runs counter to the overall business cycle. Therefore, countercyclical macro policies may reduce the amplitude of the business cycle but increase the amplitude of the housing cycle between stabilizing housing and the economy (von Furstenburg, 1979).

These interrelationships have implications for both housing policy and macroeconomic policy. The achievement of housing goals may require different programs depending on the macroeconomic policy being pursued; and likewise macro policy must be aware of housing policy. But more important, given our current stabilization problems, the design of a macroeconomic policy must recognize its uneven effects on households and industries. A restraint policy designed to reduce prices should ensure that a given price reduction is achieved in the most equitable fashion, and that

a price reduction is achieved with minimum contraction of output. For example, one might speculate, if a small slack in the housing sector restrains labour costs but further slack has no further price changes, a sound policy may be to shelter the housing sector after the initial slack and spread restraint to other industries. However, there exists little knowledge of how to execute a sectoral-specific macroeconomic policy and how this might yield greater price reduction for given restraint, so policy development must await further research. It has been suggested that housing be sheltered from the effects of high interest rates in order to reduce public opposition to a 'necessarily' restrictive monetary policy.

In 1979 and 1980, there was considerable pressure on all governments to provide some form of assistance to homeowners who were refinancing their homes. Fortunately this pressure was resisted. However, we will likely face high interest rates for the next several years and pressures will reappear. It is clearly inappropriate to mount a universal subsidy to reduce the mortgage payments of homeowners. There is, though, a question we must face: what is the fair way to share the burden of restrictive monetary policy? A strong case could be made that rough market justice must prevail because there is no alternative, but no one should have to suffer extreme hardship. Loss of a home, for example, might be deemed an extreme hardship. A similar sort of logic justifies use of tax monies to provide unemployment relief regardless of the income and wealth of the person who loses their job. We have had little need to confront such issues in the past, but they deserve to be part of current debate.

HOUSING POLICY FOR THE 1980s

Discussions of future housing policy usually begin by forecasting new housing 'requirements' resulting from increases in population (Canada, 1969; Ontario, 1977a). However, this approach ignores the problem of how to establish the desirable stock of housing, recognizing that resources have valuable uses elsewhere.[18] Economic analysis suggests that govern-

18 A demand for housing forecast can be of use if there is concern about mobility of resources. Forecast demand would be compared to 'usual' rates of supply, to establish whether new resources will have to be attracted to the industry in significant quantities. The central issue, however, is resource immobility, not 'housing requirements.'

ment should ensure income is distributed equitably and that markets operate efficiently in order that the millions of decisions of firms and households can jointly establish the appropriate stock of housing. The important questions for the development of future policy arise from the framework of efficiency and equity outlined in the previous section.

What is society's standard of a fair distribution of income and will it change in the next decade? Do we wish more redistribution of income now, or will we wish more in coming years? What are the other government programs which redistribute income and how do housing programs relate to them? Are housing markets and the markets which supply housing inputs competitive? Are these markets likely to become less competitive in the coming decade? Are there externalities from housing consumption or housing tenure which require government to change prices to ensure efficient resource allocation? Do the zoning policies of local government cause an inefficient supply of smaller houses? Will macroeconomic policy present special problems for the housing sector? By answering these questions existing policies can be judged and the need for new programs established.

Much of the work needed to answer all these questions remains to be done. Nevertheless, we do have housing programs in place, and we are constantly making decisions about policy; if only the decision to do nothing more. We must proceed with the information we now have, while continuing theoretical and empirical research. The recommendations made below are offered in this light.

Recommendations

(1) The objective of housing policy in the long run should be to phase out existing subsidy programs and to introduce a comprehensive income security system. The objective should not be to establish a shelter allowance.

Existing housing programs reduce the price of one necessity - housing. But households have other necessities. Inadequate housing is just a very evident manifestation of lack of income. The income problem should be addressed directly. Current policy distributes benefits inequitably; only a fraction of the eligible can participate, and often higher-income people get

greater benefits than lower-income people. A well-designed income security system would rectify this.

Numerous critics of housing policy, both those who support (Dennis and Fish, 1972) and those who oppose (Walker, 1976) government intervention in the economy, have suggested a shelter allowance as a preferred policy. Many of those who criticized proposals to permit the deduction of property taxes and mortgage interest recommended a shelter allowance as an alternative. Under a shelter allowance, households receive assistance to be spent on housing they choose in the private market. The location and type of housing is determined by the household. The money can help pay rent or any costs of ownership. A shelter allowance is likely preferable to the existing system. However, it focuses too much on the housing issue. Its recommendation is the product of seeing housing programs as distinct and separate, rather than as one of many instruments society uses to provide income support.

A phasing out of public housing has recently been proposed (Metropolitan Toronto, 1979). Public housing buildings would be sold to private landlords under the terms of the non-profit program, which permits up to about one-quarter of the tenants to be charged a rent geared to their income. This would require that three-quarters of the existing tenants find accommodation elsewhere, likely under the rent supplement program. Considerable concern has been voiced by tenants who find the public housing program preferable to the rent supplement. Any successful phasing out strategy will have to offer an alternative which tenants prefer. A cash grant (which would be much less than the current subsidy level per public housing unit) payable to the tenant might be such an alternative.

(2) Rent controls should be removed.

It is highly likely that rent controls reduce the supply of new housing and reduce the maintenance of existing housing.[19] Even if these effects are slight, controls are a capricious way to redistribute income. The burdens

19 Frankena (1975) shows how different control systems will have different results in terms of total housing supply and profits of landlords. Arnott (forthcoming) contains an extensive discussion of Ontario's rent review system and its impact.

are borne by those who own residential rental real estate, at least in the short run. Not all of these are wealthy people, and certainly not all wealthy people own rental housing. The benefits are enjoyed according to how much rental housing is consumed. Many poor do not rent housing, and higher-income persons enjoy greater benefits than lower-income persons.

The removal of rent controls is obviously politically difficult. Any change which will increase rents will be protested; and there are more tenants than landlords. A sudden removal of controls would be unlikely to cause an enormous jump in rents, although rents on certain dwellings might rise dramatically. A procedure worth considering would be to leave the rent review system in place but to change the regulations so that the constraints gradually are not binding. Allowable costs which may be passed through would be extended to include the true economic costs of all inputs, including a normal return to invested capital. The maximum increase without review would be retained, and a maximum possible increase in any one year would be established. Rents could then gradually move to market-determined levels.

(3) The Registered Home Ownership Savings Plan (RHOSP) should be discontinued.

The RHOSP results in millions of dollars of lost tax revenue annually. The alleged externalities from home ownership cannot justify this subsidy. The changes in incomes and house prices provide no rationale either. Potential home buyers have not become worse off over the last decade. The standard bundle of consumer goods, including buying a house, can be bought today using a lower fraction of income than ten years ago or twenty years ago.

The discontinuation of the RHOSP should be a first step in an examination of the treatment of the housing sector under the Income Tax Act to ensure the provisions promote efficiency and equity. Critical scrutiny of many sections of the Act is beginning, stimulated by the publication of the Tax Expenditure Account (Canada, 1979).[20]

20 Canadian Taxation has carried many articles on special provisions of our tax system called 'tax expenditures.' Examples of articles relating to housing are Smith (1979b), Fallis (1979), and Jump (1979).

(4) The allowable ratio of annual payments to income should be raised for mortgages insured under the National Housing Act.

Over the last twenty years, the price of carrying a new house has risen faster than the general price level - the relative price of housing has increased. The rise of all prices and incomes has meant that households can buy a standard bundle of goods using a lower fraction of income than before. However, the fraction of all expenditure which must go to housing has risen. The mortgage market has not adjusted adequately for this change in relative prices. Suppose, as an example, a household's income has just matched the increase in all prices. If in 1961 the ratio of annual carrying costs to income were 33 per cent, in 1976 buying the same bundle of goods and services would imply that 50 per cent of income was spent on housing. In 1961 the household would have been able to obtain a mortgage. In 1976, they would not.

The difficulties facing home buyers of recent years can best be met by changing the instruments available to finance a home, rather than by attempts to subsidize the price of housing or transfer income to these people. To encourage private financial markets to adjust, the federal government should raise the allowed ratio of the NHA-insured loans.

(5) The market power of landowners and firms in the development industry should be closely and continuously evaluated.

Several careful studies in the last few years (Markusen and Scheffman, 1977; Muller 1978; and the Land Task Force, 1979) examined the degree of concentration of land ownership and of the development industry in major Canadian cities. All concluded there was no significant market power. However, many policies and decisions of local government have increased the resources needed to undertake land development and made the entire process more risky, both of which encourage large firms over small. The increased use of lot levies, the requirements that developers finance hard services, increased citizen input into the planning process, and increased regulation of land development have had this effect. The Land Task Force (1979, 73), concluded that 'while there is no evidence that monopoly power is a problem now, it could become a significant problem in the future if these policies and trends are not reversed.' No one argues these policies

should be abandoned. However, the benefits of greater citizen participation or land use control must be weighed against the potential increase in the market power of a few firms.

(6) The province should establish grants to municipalities as incentives to approve new housing which has assessed value below the average of that community.[21]

When a residential development is added to a community it requires increased expenditures to provide public services and at the same time it brings new assessments which yield increased tax revenues. Municipal councils represent existing residents, not possible newcomers, and therefore try to ensure all developments generate offsetting new revenues and expenditures. This is especially true at present when there is strong opposition to property tax increases. However, local councils responsibly representing the interest of their voters, when taken together, unduly restrict the development of inexpensive housing. It is the role of the province to offset this. A system of incentive grants is likely preferable to increased provincial control of the approval process.[22]

The above package of proposals calls for a significant curtailment of programs explicitly dealing with housing. This does not imply a retreat from the goal that all Canadians should enjoy adequate shelter. On the contrary, the proposals represent an attempt to use our resources more equitably and efficiently towards this goal. In the past, housing programs have evolved in a chaotic and ad hoc fashion. A program was initiated in response to each complaint, but only a small fraction of the eligible was ever assisted. There was no systematic exploration of the rationale for government intervention, no assessment of the fairness of the entire policy, and little attempt to place policy in the broad context of our income

21 The federal government in the past has made such incentive grants under the Municipal Incentive Grants Program. These funds have been consolidated with other programs into a single Community Services Grant Program which provides funds to provinces. It is recommended that the province develop an explicit incentive program.

22 The recent Report of the Planning Act Review Committee (Ontario, 1977b) has suggested that municipalities be assigned more planning responsibilities except where there is a clear provincial interest. The incentives recommend here are consistent with local decision-making and the recognition of provincial interest.

security system. The recommendations represent an attempt to redress these problems. They emphasize the two goals of achieving an equitable distribution of income and a properly functioning housing market. The proposals have been made very specific in the hope they will provoke discussion and sharpen public debate about the alternatives for the 1980s.

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